

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)	
MICHIGAN GAS UTILITIES for approval of)	
its gas cost recovery plan and factors for the)	Case No. U-11192
12-month period ending December 31, 1997.)	
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At the July 31, 1997 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. John G. Strand, Chairman
Hon. John C. Shea, Commissioner
Hon. David A. Svanda, Commissioner

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

On September 30, 1996, Michigan Gas Utilities (MGU) filed an application, with supporting testimony and exhibits, seeking authority to implement a gas cost recovery (GCR) plan and factors for the 12-month period ending December 31,1997.

Pursuant to due notice, a prehearing conference was held on November 5, 1996, before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). MGU, the Association of Businesses Advocating Tariff Equity (ABATE), Attorney General Frank J. Kelley (Attorney General), the Residential Ratepayer Consortium (RRC), and the Commission Staff (Staff) participated in the proceedings.

On February 14, 1997, the parties informed the ALJ that they had reached a partial settlement agreement that resolved all but two issues.¹ Pursuant to Paragraphs 5A and 5B of the partial settlement agreement, the parties submitted the prefiled direct testimony and exhibits of three MGU witnesses and one Staff witness into evidence without cross-examination. Briefs and reply briefs were filed by MGU, the Attorney General, and the Staff on March 10 and 24, 1997, respectively. The RRC filed a brief, but not a reply brief.

On April 24, 1997, the ALJ issued a Proposal for Decision (PFD). On May 12, 1997, exceptions to the PFD were filed by MGU. On May 27, 1997, replies to exceptions were filed by the Attorney General and the Staff.

II.

DISPUTED ISSUES

Prior Period Forecasted Underrecovery

It is MGU's position that its 1997 monthly GCR factors may properly include as a cost of gas its forecasted 1996 GCR underrecovery. Citing Section 6h of 1992 PA 304 (Act 304), MCL 460.6h et seq.; MSA 22.13(6h) et seq., and the March 29, 1995 order in Case No. U-10747, MGU argues that the Commission authorized it to replace its historical refund and surcharge procedure with a new procedure that calls for amounts associated with refunds or surcharges to be "rolled into" its GCR factor for the following year. Moreover, MGU stresses that the Commission's order in Case No. U-10385, which it says authorized Michigan Consolidated Gas Company (Mich Con) to use rolled in refunds in the same manner as proposed in this proceeding, was affirmed by the Court of Appeals in Attorney General v Public Service Commission, 215 Mich App 356; 546 NW2d 266 (1996).

¹In an order issued on February 20, 1997 in Case No. U-11192, the Commission approved the partial settlement agreement.

The Staff, the Attorney General, and the RRC oppose MGU's attempt to use a forecast of its 1996 GCR underrecovery in calculating its 1997 GCR factor. They argue that MGU's proposal is contrary to MCL 460.6h; MSA 22.13(6h), case law, and prior Commission orders. According to them, there must first be a Commission determination in a GCR reconciliation proceeding that MGU's prior period underrecovery was reasonably and prudently incurred before the amount of the underrecovery can be rolled into the subsequent year's GCR factor. Citing Michigan Gas Utilities v Public Service Commission, 200 Mich App 576; 505 NW2d 27 (1993), they stress that recovery of GCR costs for a prior plan period can be collected only after a reconciliation case and a finding by the Commission authorizing recovery of such costs.

The ALJ agreed with the Staff, the Attorney General, and the RRC. He found that before MGU can recover a prior period underrecovery, there must be a Commission determination pursuant to MCL 460.6h(14); MSA 22.13(6h)(14) that the excess GCR expenses were beyond the utility's ability to control through reasonable and prudent actions. Because MGU's proposal would allow MGU to collect a prior period underrecovery without first establishing that recovery of such expenses is appropriate under MCL 460.6h(14); MSA 22.13(6h)(14), the ALJ concluded that MGU's proposal was illegal and should not be adopted by the Commission.

In its exceptions, MGU argues that the Commission's March 29, 1995 order in Case No. U-10747 granted it permission to replace the historical refund and surcharge procedure with a new procedure that permits the difference between forecasted and actual GCR costs to be rolled into the cost of gas for the next year's GCR factor. Arguing that the Commission² and the Court of Appeals³ have already concluded that Act 304 permits the cost of gas, for purposes of calculating a GCR factor, to include the amount of a prior period

²Citing the June 30, 1994 order in Case No. U-10385 and the March 29, 1995 order in Case No. U-10747.

³Citing Attorney General v Public Service Commission, *supra*.

underrecovery, MGU insists that the PFD fails to recognize that the question is not whether its 1997 GCR factor should include an underrecovery amount, but whether such underrecovery amount may be properly included in its 1997 GCR factor prior to completion of MGU's 1996 GCR reconciliation proceeding. It is MGU's position that reliance upon forecasts in the determination of its annual GCR factor that are subject to adjustment and reconciliation is the hallmark of Act 304 and is entirely consistent with its proposed roll-in methodology, which relies on a forecast of its 1996 GCR underrecovery. MGU points out that allowing forecasted underrecoveries to be reflected in the GCR cost of gas for a subsequent plan year will save customers money by reducing their interest payments. Further, MGU argues that subsequent reconciliations will provide safeguards preventing MGU from recovering GCR costs that are ultimately determined to be unreasonable or imprudent. Further, MGU stresses that the Commission has the ability to review the reasonableness of its forecast for an underrecovery in establishing the appropriate amount of MGU's future GCR factor. Accordingly, MGU insists that the PFD took a much too narrow view of MCL 460.6h; MSA 22.13(6h) in light of the Commission's considerable discretion in choosing a methodology for handling GCR underrecoveries.

In their replies to exceptions, the Staff and the Attorney General maintain that Act 304 prohibits a utility from including a forecast of a prior period underrecovery in the calculation of a future GCR factor. Although conceding that the Commission and the Court of Appeals have held that a utility can legally include a prior period over- or underrecovery in its GCR factor for a future period, the Staff and the Attorney General maintain that it would be an express nullification of the GCR plan period time limits stated in subsections 3 and 12 of the MCL 460.6h; MSA 22.13(6h) if utilities were allowed to add prior period forecasted underrecoveries to GCR factors proposed for a GCR plan year. The Staff and the Attorney General also maintain that it is specious for MGU to argue that its proposal will save its GCR customers any money because the purpose of interest is to reflect the time value of money. Indeed, they insist that if MGU collects

its underrecovery sooner, then its customers will, and should, pay less because they have had the use of MGU's money for a shorter period of time.

The Commission finds that MGU's exception to the PFD should be granted. In particular, the Commission is persuaded that Act 304 does not preclude adoption of the roll-in methodology proposed by MGU. In Case No. U-10385, Mich Con first proposed the abandonment of its existing historical refund system in favor of a system that featured refunding and surcharging through monthly fluctuations in the cost of gas to immediately recognize disparities between the estimated and the actual cost of gas. However, the Staff was not persuaded that the month-by-month adjustments proposed by Mich Con were appropriate. Rather, the Staff recommended that any net annual overcharge or undercharge be rolled over into the next year's GCR reconciliation. In so doing, Roger A. Lamb, a Gas Operations Refund Specialist in the Commission's Gas Division, testified in support of the Staff's proposal. Among other things, Mr. Lamb took the position that, in the event that a utility was not able to neutralize an underrecovery by charging its maximum GCR factor, it would have the option "to request a higher factor in its subsequent plan filing to recoup an underrecovery." 6 Tr. 1072, Case No. U-10385. The Commission adopted the Staff's proposal in its June 30, 1994 order in Case No. U-10385.

The Attorney General appealed the Commission's June 30, 1994 order. In rejecting the Attorney General's appeal, the Court of Appeals stated:

The PSC's decision is not unlawful because MCL 460.6h(13) and (14); MSA 22.13(6h)(13) and (14) give the PSC discretion in fashioning refund and surcharge procedures. These provisions authorize, but do not require, the historical system that distinguished between classes of ratepayers. . . . We believe that the language of the statute evinces a legislative intent to assign to the PSC the task of balancing such concerns and addressing the reasonableness of refund and surcharge procedures. We find no basis in law or on the record to upset the PSC's decision in the case.

Attorney General v Public Service Commission, 215 Mich App 356, 369-370; 546 NW2d 266 (1996).

Because the Commission has broad discretion to fashion refund and surcharge procedures pursuant to MCL 460.6h(13) and (14); MSA 22.13(6)(13) and (14), the Commission finds that MGU may be authorized to rely upon a forecast of a prior period underrecovery to roll a prior period GCR underrecovery into a future period GCR factor. Of course, the reasonableness of any forecasted underrecovery included in MGU's future GCR factor is a matter that is subject to the determination of the Commission in establishing the utility's GCR factor. Moreover, the amount of the forecasted underrecovery is also subject to review and revision in the utility's annual GCR reconciliation proceeding.

MGU's Standardized Reopening Proposal

Jeffrey T. Cook, a rate analyst responsible for tracking MGU's GCR factors, testified that the Commission should adopt the methodology set forth in Exhibit A-15, which depicts MGU's projection of its 1996 GCR underrecovery, as a standardized methodology for reopening a GCR plan proceeding for the purpose of increasing the maximum GCR factor. According to Mr. Cook, because MGU's plan includes the continued use of market pricing for the vast majority of its natural gas supply purchases, there is a need for a standardized reopening procedure that allows for adjustment of the GCR factor in response to market price volatility. Because there is currently little guidance as to the specific components or methodology that should be followed in reopening a GCR plan proceeding, Mr. Cook indicated that adoption of the guidelines set forth in Exhibit A-15 would simplify GCR reopening proceedings. Mr. Cook also stated that MGU is concerned that, absent cooperation of the other parties, its efforts to reopen a GCR plan could involve a lengthy contested case proceeding that would delay implementation of a much needed increase in its GCR factor, which would complicate the utility's efforts to recoup an underrecovery.

MGU's proposed methodology was opposed by the Staff, the Attorney General, and the RRC. They contended that MGU's proposal would violate Act 304 because it proposes restrictions on the parties that are

inconsistent with the requirement that a reopened GCR proceeding must be conducted as a contested case proceeding under the Administrative Procedures Act of 1969, 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq. (APA).

The ALJ found that MGU's proposal should be rejected. According to the ALJ, although MGU's proposal would permit an expeditious resolution of a reopened GCR case by narrowing of the scope of the proceeding, its implementation would violate MCL 460.6h(10); MSA 22.13(6h)(10), which requires that a reopened GCR case be conducted as a contested case proceeding.

In its exceptions, MGU argues that its proposal merely streamlines and narrows the focus of the reopened proceedings. According to MGU, its proposal would not preclude or foreclose any other party from seeking to reopen the GCR plan case on any other basis. Further, arguing that limited issue proceedings are consistent with the contested case requirements of the APA, MGU insists that the Commission may limit the scope of a reopened GCR case. Moreover, MGU contends that it would first attempt to obtain the consent of all other parties to the GCR plan case before invoking its proposed GCR reopening methodology. In any event, MGU maintains that other parties would be protected because they would have an opportunity to respond to MGU's action through the filing of written comments and affidavits.

In their replies to exceptions, the Staff and the Attorney General argue that the ALJ properly concluded that Act 304 does not allow MGU to limit the scope and methodology for reopening a GCR plan proceeding. They insist that a reopened GCR case must be conducted as a contested case with appropriate notice and opportunity to participate. Accordingly, they maintain that it would be inappropriate for the Commission to preordain the mathematical guideline described in Exhibit A-15 as the standardized methodology that must be followed in the event that MGU's GCR plan must be reopened to deal with the problem of unanticipated increases in the spot market price of gas.

The Commission finds that MGU's proposed standardized GCR reopener mechanism should be rejected. Over the course of the 14 years that the GCR process has been in effect, MGU's gas acquisition strategy has evolved from relying heavily upon long-term contracts with fixed prices to its current strategy of relying heavily upon shorter-term contracts with market-based prices. While there have been significant changes in the regulation of the natural gas industry that are responsible for many of the changes in MGU's gas acquisition strategy, the Commission is persuaded that MGU's decision to rely more heavily upon the spot market does not justify adoption of the standardized reopening procedure proffered by MGU. However, Act 304 does provide MGU with an alternative mechanism for coping with the vagaries of the spot market. MCL 460.6h(6); MSA 22.13(6h)(6) permits MGU to include in its GCR factors a specific amount that is contingent upon a future event. This provision permits the use of contingent GCR factors, but only when those factors are tied to specific future events. Thus, in a proper case, MGU could propose, and the Commission could approve, a contingent GCR factor that is triggered by a future event to address spot market price volatility.

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; MSA 22.21 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1982 PA 304, as amended, MCL 460.6h et seq.; MSA 22.13(6h) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.
- b. Implementation of MGU's 1997 GCR plan, as modified by this order, should be approved.

THEREFORE, IT IS ORDERED that Michigan Gas Utilities' implementation of its gas cost recovery plan and factors, as modified by this order, is approved for the 12-month period ending December 31, 1997.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

John G. Strand

Chairman

(S E A L)

John C. Shea

Commissioner

David A. Svanda

Commissioner

By its action of July 31, 1997.

Dorothy Wideman

Executive Secretary

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MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
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its gas cost recovery plan and factors for the)
12-month period ending December 31, 1997.)
_____)

Case No. U-11192

Suggested Minute:

“Adopt and issue order dated July 31, 1997 resolving two issues concerning Michigan Gas Utilities’ implementation of its gas cost recovery plan and factors for the 12-month period ending December 31, 1997, as set forth in the order.”